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JOINT POLICY COMMITTEE — REGIONAL PLANNING PROGRAM

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To: Joint Policy Committee

From: Regional Planning Program Director

Subject: New Revenue Sources to Support Priority Development Areas

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At its meeting of January 18, 2008, the JPC considered various options for allocating funds through the Regional Transportation Plan (RTP) to support Priority Development Areas (PDAs). Recognizing competing demands on existing funds, the Committee called for a comprehensive and relatively unconstrained consideration of new revenue sources which could be employed to assist PDAs. This memo is intended to start that consideration by inventorying potential new taxes and fees that could be collected at the regional level and directed to PDAs and possibly to other aspects of the region's focused-growth efforts. The revenue sources are identified only in broad outline at this time. If the Committee is interested in pursuing any of these fees or taxes, then a much more detailed analysis, including most importantly a calculation of potential yield, will be required.

Issues in Common

As the State of California is all too painfully aware, money to pay for all sorts of good public purposes does not come easily. Pursuing any new revenue source will be difficult and time consuming, and there may be a high political price to pay. There are three core issues that all new revenue sources share to varying degrees:

1. Authority
   With one arguable exception, the regional agencies do not have current authority to levy any of the proposed fees or taxes. We will need to go to the State Legislature, to the voters, or to both to obtain authority. Approval of some—maybe most—authorities will require super majorities.

2. Nexus/Purpose
   The imposition of fees generally requires that there be a clear connection or "nexus" between the fee source and the services or investments being funded (i.e., that revenues are used to fund things which either serve or are caused by the activity to which the fee is applied). For example, a fee levied on a gallon of gasoline must be used to either provide transportation services (fill potholes) or mitigate the impact of using that gallon (reduce CO_2). While most of us would contend that the potential to reduce vehicle miles traveled (VMT) provides a strong nexus between focused growth and transportation-related fees,

there is a high probability that a court challenge would result in a more conservative test. Using transportation fees to fund non-transportation expenditures in PDAs, therefore, involves a substantial element of risk. The quality of nexus would obviously vary with the type of fee.

In contrast to fees, most taxes do not formally have to pass the nexus test. However, there is still a political requirement to explain and justify the tax to the approving entity, be it the legislature or the voters. While most people can relate to the purpose of a road widening or a transit expansion and see how it would benefit them or people like them, the public purpose of compact development in specific places is more difficult to grasp. A tax aimed exclusively, or even mostly, at funding focused growth may be a difficult sell.

3. <u>Tax Burden / Tax-base Crowding</u>

   Different taxes affect different income groups and different elements of society differently. Therefore, it is simplistic in the extreme to contend that there is an archetypical California taxpayer and that this poor, representative individual is already grossly overburdened with charges levied by various levels of government. Nevertheless, there will be inevitable public resistance to any reduction in disposable income for purposes of improving the commonweal. While there is some demonstrated public sympathy for new taxes related to fighting climate change, taxpayers are also very sensitive to the size, incidence, and rationale for those taxes. To win voter approval, any new tax will have to be very carefully crafted.

   Related to the perception of tax burden is the phenomenon of tax-base crowding. Taxes directed to a regional purpose, like focused growth, are potential taxes not directed to some other worthy public purpose. Local and state governments will jealously guard their revenue sources and resist any usurpation of revenue capacity by regional agencies.

4. <u>Equity Consequences</u>

   Nearly all the potential revenue sources are taxes and fees levied on basic commodities or on behaviors over which people have limited discretion. Therefore, there is a high probability of inequitable or regressive consequences. Credits, exemptions, subsidies, investments in alternative transportation choices, or combination mechanisms will be required to mitigate these consequences.

Given these issues to overcome, it is reasonable to expect that substantial new sources of revenue will not become an allocation reality until the 2013 update of the RTP at the earliest. In the interim, to maintain momentum and to kick-start progress on the region’s climate objectives, it may be necessary to further subdivide the existing regional pie and dedicate some present discretionary funding to PDAs and focused growth. Preparing a regional transportation plan is about setting priorities for always limited funds. If focused growth is truly a regional priority, then it should be worth at least some marginal reallocations from a few perceived entitlements to help make it happen. There is also sufficient overlap among existing regional discretionary programs and PDAs to direct a somewhat increased proportion of program funding to PDAs without compromising the core purposes of those programs at all.

Some Possibilities

What follows is a cursory catalog of potential new revenue sources. The emphasis is on taxes and fees related to transportation use or land development, as the rationale for funding PDAs from these sources is relatively obvious and direct. This is not to preclude supporting PDAs with funds derived from more traditional general revenue sources—income, sales and property taxes—but competing priorities and issues of tax-base crowding quickly come into play when considering these core government revenues.

The catalog is without price information. There is no attempt to hypothesize tax or fee levels or to estimate aggregate revenues at this time. It is important to first concentrate on taxation or user-fee principles. If the principles underlying a particular revenue source are acceptable, we can next test its sensitivity to different price levels and estimate its revenue-generating capacity.

1. General Transportation-related Fees and Taxes

1.1 Gasoline Fee
MTC and the Air District are jointly seeking legislative authority to ask Bay Area voters to allow the levy of a per-gallon fee on the sale of gasoline, the proceeds of which would be used for local roads maintenance and climate protection. The draft legislation includes specific uses for the money, but does not include support for focused growth or PDAs, as our legal advisors are worried about passing the nexus test. Unlike a tax, a fee only requires a simple majority (50 per cent plus one) to pass. Assembly Member Jared Huffman has authored legislation which levies a fee for climate protection purposes only.

1.2 Gasoline Tax
MTC currently has the authority to go to the voters and ask for a regional gasoline tax. However, the imposition of a new tax requires a two-thirds super majority, and polls have suggested that this level of support is not yet attainable. Assuming no immediate changes in the burning efficiency of gasoline blends, both the gasoline tax and gasoline fee have the desirable quality of acting like a carbon tax, as the amount of revenue generated will be roughly proportional to the amount of CO_2 released into the atmosphere. Both gas taxes and gas fees are subject to revenue erosion as vehicle fuel economy increases. If given the authority, the region would likely implement a fee or a tax, but not both

1.3 VMT Fee or Tax
Oregon and a few other jurisdictions have begun experimenting with the idea of a VMT fee. This a road-use charge levied on the basis of odometer readings. Its principal advantage is that, unlike a gas fee or tax, it would not be subject to revenue erosion as fuel efficiency increases. It may also act as a disincentive to the increased driving that would otherwise occur with more fuel-efficient vehicles. This disincentive will restore some of the climate benefit associated with efficient vehicles and have other transportation benefits as well. Reduced VMT should help moderate congestion levels and road wear. However, a VMT fee will clearly not act like a simple carbon tax, and

the nexus to focused growth is indirect. The broad-based implementation of a new technology would also be required to efficiently collect a VMT fee, and there are administrative issues related to out-of-region and out-of-state automobiles.

1.4 Vehicle License (Registration) Fee (VLF)

This would be a regional increment to an existing state revenue source with an administrative system for collection already in place. Were it accompanied by self-reporting of odometer readings (similar to self reporting of income for tax purposes), it could take on some of the desirable characteristics of a VMT fee (assuming random audits to assist honesty). A fee schedule based on vehicle fuel efficiency could also act as an incentive to energy conservation.

MTC is already pursuing a one-dollar VLF increase to help pay for freeway performance initiatives. It may be feasible to add to the fee request to also cover incentives for focused growth. Remember, however, that a VLF increase implemented earlier in this decade was one of the major issues behind an unscheduled change in State administrations and was rescinded shortly after the election of a new Governor. VLF increases have a definite political third-rail quality. A regional license fee capable of withstanding political challenge would likely have to be very moderate and clearly linked to a popular purpose.

1.5 Parking Fees and Taxes

Some Bay Area local governments already collect surcharges on commercial parking fees and rents, and there may, therefore, be some tax-base crowding issues associated with a regional parking levy. However, increased commercial parking costs can send important price signals and generate substantial revenue to boot.

There are two substantively different ways of implementing a regional parking levy: (1) as a "sales tax" on commercial parking charges paid by parking consumers, or (2) as a "property tax" on commercial parking spaces whether or not the parker pays a charge. Combinations are also possible. The "sales tax" approach is administratively easier and can act as trip-demand meter on denser more congested locations where pay parking is more common. The "property tax" approach including "free" parking spaces, while requiring more difficult administration is more comprehensive and arguably more equitable. It could impact many more and a greater variety of trips. Most importantly, it could also help counteract the commercial sprawl incentive which could be an unintended consequence of a parking sales tax implemented only in relatively dense concentrations of commercial space. From a VMT reduction perspective, a fully effective parking tax system will discourage free parking regardless of location. If all parking is priced, people will be more inclined to combine trips and to think twice about making discretionary trips.

2. Road Pricing

The region is actively considering a number of pricing mechanisms to better manage use of the system and coincidentally generate some revenue which could pay for system improvements. The target analysis for the RTP has demonstrated that focused growth as implemented through

PDAs can have a higher impact on VMT and emissions than most conventional transportation investments. It is, therefore, altogether appropriate to consider using some road-pricing revenue to invest in PDA development and to conceptualize PDAs as transportation projects.

2.1 Bridge Tolls

The region currently uses some toll revenue from the seven state-owned bridges to finance improvements to the region-wide transportation system. Current toll revenue, including some future increments, is fully committed. However, as we increasingly come to regard PDAs as integral to our transportation system, it will make sense to fund some PDA investments as transportation-system improvements. This will likely require new or renewed authorities, but the collection system is clearly already in place. A major issue is that only a small subset of the region's trips cross the bridges and therefore a small subset of drivers will be shouldering the increased cost burden. As well, only a subset of the region's trips would be disincentivized.

2.2 HOT Lanes

The next most likely large-scale extension of road-pricing principles in the Bay Area will be the implementation of HOT lanes. The HOT-lane concept would allow the drivers of single-occupant vehicles to by-pass congestion by paying a fee to drive in the same express lanes as high-occupancy vehicles (HOVs). Initial HOT-lane revenues will likely be dedicated to completing and extending the HOT lanes themselves. After that expenditure, the monies might be used to fund general system improvements, including PDA development. However, surplus revenue from this source is only likely to be available in the very long term if ever.

2.3 Cordon Charges

The Bay Area (San Francisco in particular) is considering the possibility of vehicle entry fees to particularly congested parts of the region. Such fees are already in place in Singapore, Stockholm and London and are under active consideration for New York. The successful implementation of these fees requires that revenue be first used to fund transportation alternatives to the private automobile: generally transit, but also including bike and pedestrian improvements, taxis, and car sharing. Once an improved non-auto system is in place, other uses of revenue could be considered. A worthy expenditure might be PDA infill incentives within the pricing cordon. In the near to medium term, this will likely only have applicability to the city of San Francisco.

2.4 Open-Road Tolling

Automated electronic collection, either through transponders or digital photography of license plates, makes it theoretically possible to collect toll revenue anywhere on the highway system, not just at choke points like bridges and tunnels. Automated collection can also occur without generating its own bottlenecks, as there is no need to stop or even slow down. However, without creating direct travel impediments, open-road tolls can send important price signals which will influence the routes, times, and modes which people choose to travel. That will help us optimize the transportation capacity we are able to provide. It will also generate revenue which can fund transportation system improvements including more supportive land use. However, before open-road tolling can be implemented, a significant and expensive technological infrastructure would have to be in place and the privacy concerns associated with regular monitoring of vehicle location would have to be put to rest.

3. Land Development Fees and Taxes

3.1 Indirect Source Fees

Regional air quality agencies, including BAAQMD, have the authority to set rules and levy fees to mitigate air pollution resulting from new residential, commercial and industrial development—including travel to and from the development, during and after construction. This authority has been exercised by the San Joaquin Valley Air Pollution Control District, which requires developers to either reduce impact with site-specific improvements or pay off-site mitigation fees. Impact, including travel generation, is estimated using a project-specific computer model, URBEMIS. During its first year of operation, the Valley Indirect Source Rule program collected just short of $13 million in fees. In theory, fees could be directed to assist emission-reducing development elsewhere in the region.

Transferability to the Bay Area is subject to resolution of at least a couple of issues: (1) the San Joaquin rules have been challenged in court by development interests, and (2) the Bay Area currently performs much better on criterion pollutants than the Valley, so the imperative to take extraordinary measures is not as great here. Relative to the first issue, the rules have just been upheld by the Fresno County Superior Court, but an appeal may be possible. Regrettably, climate change may resolve the second issue. As temperature rises, there will many more hot days that cook precursor gases with the result that we will exceed ground-level ozone limits much more often than presently. We will then need to redouble our efforts to control criterion pollutants. As development has long-lasting impacts, it may not be too early to anticipate future changes by implementing indirect source rules now.

3.2 Traffic Mitigation Fees

These are similar to indirect source fees, but only levied on commercial development. C/CAG in San Mateo County currently has a system in place which allows developers to either directly mitigate traffic impact through demand management (TDM) strategies or pay a new trip fee. Revenue may be limited, as most opt for TDM.

3.3 Commercial Linkage Fees

A few Bay Area municipalities, including San Francisco, currently levy a per-square-foot fee on new commercial development. In most cases, the collected fees are used to support affordable housing development. In San Francisco, they are also used for transit. The theory is that commercial space is filled up with employees, and those employees require housing and transportation services. The developer, who benefits from the occupancy of new commercial space, also has an obligation to mitigate some of the social and public costs resulting from that occupancy.

Most local governments do not have linkage fees for fear that it will put them at a competitive disadvantage in attracting desired commercial development and associated property and sales taxes. Implementation of a linkage fee at the regional level would obviate that fear, as all jurisdictions (at least within this region) would be on the same level playing field. Expanding the base of affected commercial projects would also increase the potential total funding available, even at lower per-square-foot rate than present local linkage programs. That rate would have to set low enough so as not to put the region as a whole at a competitive disadvantage relative to other regions.

In moving linkage fees to the regional level, there would be a need to keep the faith by continuing to use them for the same purposes as presently, mostly affordable housing. This should not be an issue as affordable housing will likely be a priority requiring funding in nearly all PDAs.

3.3. Payroll Taxes

While not strictly a tax on development, payroll taxes share essentially the same rationale as commercial linkage fees: they are a tax on the impacts of economic activity and employment, paid by the employer rather than employee. They may have a somewhat more progressive quality, as they implicitly assume (perhaps inaccurately) that higher paying jobs have a greater impact than lower paying jobs. Metro, the regional government for the Portland, Oregon area, draws upon payroll taxes to fund many of its activities. Unlike linkage fees, which are levied one time per building, payroll taxes are a continuous, albeit somewhat volatile, source of revenue. Like linkage fees, there is some benefit in levying them on a regional level in order to obviate intra-regional tax competitions, though inter-regional competitiveness could become an issue depending on tax level.

3.4 Tax Increment Financing (TIF) / Betterment Levies

California law permits redevelopment authorities to finance infrastructure and other community improvements using the tax increment resulting from higher property valuations. Those valuations are assumed to increase because of the community improvements themselves and because of associated up-zoning. With a few limited exceptions, however, TIF is only available in redevelopment areas which have been deemed “blighted”. Amending state law to make TIF available to PDAs regardless of existing conditions could provide a useful financial tool. This has been proposed for transit villages but has been resisted by school districts and other property tax recipients because of perceived tax-base crowding issues.

The betterment levy is a related concept, more familiar outside the United States. A betterment levy is a direct tax on the increase in property value resulting from a legislative action like an upzoning. It functions more like a capital gains tax than a property tax.

Neither a TIF or betterment levy implementation would require the regional collection or distribution of funds. However, regional designation of a PDA area could trigger the local ability to use these financing mechanisms.

4. Other: Carbon Trading

All the revenue sources we have cataloged are difficult and speculative. This, however, is by far the most difficult and the most speculative. It is included in the catalog for reasons of relative completeness and nearly as a last resort. It requires either the recognition of sustainable PDA development as an acceptable offset within the current informal guilt-driven “carbon-neutrality” system or the implementation of a workable, formal cap-and-trade system in which the emission impacts of development are sufficiently quantifiable to be traded among development projects and with other emitting activities. The theory is that PDAs, because they generate twenty to forty percent less VMT than conventional sprawl development, would accumulate carbon credits which could then be sold to finance required infrastructure. This is neat in theory; in practical terms it may be little more than a full employment program for lawyers and accountants. It is unlikely to be doable exclusively at a regional level.

Conclusion

This memo has identified a number of potential new revenue sources which could be employed to assist focused growth and PDA development in particular. The purpose is to put some ideas out for a first round of discussion without a lot of prejudgment. At this stage, we have applied only a very coarse realism filter: our analysis has been superficial, not critical and discriminating. However, no revenue source is without substantial policy and implementation issues. There are no pots of gold simply waiting for us to grab.

The next step is for the JPC to identify a subset of these revenue ideas, or other ideas emerging from its discussion, which are worthy of more detailed analysis and consideration. Through an incremental process of elimination, we expect we will eventually end up with one or two ideas which are truly worth pursuing at this time.

However, “at this time” is likely to extend beyond the completion date of the current Regional Transportation Plan update, and the next update is four years away. As the current RTP process proceeds through the rest of the year, it will be important to remain vigilant for opportunities to support PDAs using current revenues. The RTP vision analysis has suggested that focused growth, implemented in part through PDAs, will be a key part of the Bay Area’s transportation future. For that part to be fully realized and fully effective, we need to start building it now, not with the next RTP. While we develop new revenue sources, a number of consequential regional clocks keep ticking. Employment growth, population growth and climate change are not stopping to wait for new revenues.

Recommendation

I RECOMMEND:

THAT the JPC identify no more than about two to three new revenues sources (excluding a regional gas fee, a vehicle license fee increase, HOT lanes and congestion pricing, which are already in play) that it believes are most worthy of implementation by no later than the next RTP update in 2013, and THAT it direct staff to report back on a detailed comparative analysis of these alternatives during 2008.